89-530

Supreme Court, U.S.
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No. ___

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PORTLAND GOLF CLUB,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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QUESTIONS PRESENTED

Whether the lower court erred in holding that Petitioner, a tax-exempt social club, may properly deduct losses from a nunmember activity only if it undertakes that activity with the intent to profit, where profit means the production of gains in excess of all variable and properly allocated fixed costs.

Portland Golf Club has no affiliates, parent company or subsidiaries.

PARTIES BELOW

Parties before the United States Court of Appeals for the Ninth Circuit were Portland Golf Club as Appellee and the Commissioner of Internal Revenue as Appellant.

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PORTLAND GOLF CLUB

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Portland Golf Club, an Oregon non-profit corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals (App. A, *infra*) is not reported. The opinion of the United States Tax Court (App. C, *infra*) is not officially reported, but is unofficially reported at P-H Memo T.C, par. 88076.

JURISDICTION

The judgment of the Court of Appeals (App. B, *infra*) was entered on June 1, 1989. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 511 and 512 of the Internal Revenue Code of 1954 (26 U.S.C.) are set out in a statutory appendix, App. D, *infra*.

STATEMENT

Petitioner is a nonprofit Oregon corporation exempt from tax pursuant to Section 501(c)(7) of the Code. (App. C, 8a.) Since 1914, Petitioner has owned and operated a private club, including a golf course, restaurant, bar, swimming pool and tennis courts, for the benefit of its members, their guests and nonmembers. (App. C, 9a.)

During the fiscal years 1980 and 1981 in issue, Petitioner derived the vast majority of its income from membership dues and other fees paid by members for goods or services provided to the members and/or their guests. Members were allowed to sponsor guests, friends, and organizations to use Petitioner's facilities and services for private parties, receptions or catering (App. C, 10a), and such activities generally generated nonmember income. (App. C, 11a.) In addition, Petitioner followed prudent business standards by retaining funds for improvements and contingencies in the form of short-term investments. (CR 10, No. 12.)[1] The income earned on these investments was also nonmember income. (App. C, 14a.) The total income earned from sales of food and beverages to nonmembers, as well as from investments, constituted

[1] "CR" references are to the docket control numbers assigned to the documents in the original record by the Tax Court Clerk. The appeal was heard on the original record.

Petitioner's total gross unrelated business taxable income. (App. C, 10a.)

In providing food and beverages to nonmembers, Petitioner incurred certain variable expenses (those which vary depending on the amount of food and services provided), such as food and beverage costs, payroll, and other costs. (App. C, 11a.) In connection with providing these goods and services to nonmembers, Petitioner used facilities and personnel which were also used for exempt function purposes. (CR 10, No. 14-15; App. C, 10a.) In preparing its tax returns, Petitioner consistently deducted all of the variable expenses related solely to providing goods and services to nonmembers; it also deducted an allocable portion of the fixed overhead expenses attributable to the facilities and personnel used for both exempt function purposes and non-exempt function purposes, in accordance with Proposed Treasury Regulation Section 1.512(a)-(3)(b)(5).[2] (App. C, 12a.) These fixed overhead expenses consisted of those which were approximately the same amount regardless of the amount of food and related services provided to nonmembers, such as taxes, depreciation, utilities and salaries. (App. C, 11a-12a.)

Since 1975, through and including the years at issue, Petitioner, in its tax returns, has used an allocation formula based on the ratio that nonmember sales bore to total sales, in order to compute the amount of fixed overhead allocated to and deducted from Petitioner's unrelated business taxable income.

[2] This proposed regulation was issued on May 13, 1971 (36 Fed. Reg. 8809), and was withdrawn on January 29, 1987 (52 Fed. Reg. 2724).

(App. C, 12a.) Such method of allocation was stipulated by the parties to be reasonable. (CR 10, No. 14; App. C, 12a-13a.) The parties further stipulated that for the years at issue, an allocable portion of Petitioner's fixed overhead costs was properly attributable and directly connected to the generation of nonmember income. (App. C, 13a.)

Using this "gross-to-gross" allocation formula, Petitioner's unrelated business tax return reported losses on nonmember food and beverage sales of $28,433 for 1980 and $69,608 for 1981. Petitioner offset these losses against its taxable investment income, and reported a net loss in each year. (App. C, 22a.)

Petitioner was concerned about the profitability of private party income, substantially all of which was nonmember business. (CR 14, 7.) It conducted numerous reviews and studies of the profitability of private party income. (CR 10, J.Ex. 6-F, 7-G, 9-I, 10-J, 11-K.) Had Petitioner chosen to allocate fixed overhead for the years at issue based on the square foot and hours of actual use of facilities for the nonmember activities,[3] it would have had net taxable income for income tax purposes from the sale of food and beverages to nonmembers of $19,448 in fiscal 1980 and $23,474 in fiscal 1981. (App. C, 16a.)

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[3] This "actual use" allocation method has been adopted by the Government as an example of a reasonable allocation method in the 1980 and 1982 editions of *Exempt Organizations Continuing Professional Technical Instruction Programs* issued by the Exempt Organizations division of the I.R.S. National Office. This method was also found to be reasonable by the court of appeals in *Rensselaer Polytechnic Institute* v. *Commissioner*, 732 F.2d 1058 (2d Cir. 1984).

Petitioner's activities were run in a businesslike manner, and it kept complete and accurate books and records of its activities. (App. C, 17a.) Its Board of Directors and Finance Committee closely supervised the food and beverage operations, and in 1981 conducted a study showing that the income from sales of food and beverage to nonmembers substantially exceeded all variable costs plus a portion of the dual use fixed costs allocated based upon the number of nonmembers served divided by the total number of people served. (App. C, 18a-19a; CLR 10, J. Ex. 6-9; CR 14, 7-8.) Day-to-day operations were supervised by a manager with substantial club management experience. (App. C, 17a-18a.)

In the Tax Court, Respondent conceded that Petitioner properly allocated its unrelated deductions to income and that such deductions satisfied all requirements of Title I of the Code save one. But Respondent maintained that a club must satisfy the "trade or business" requirement of Section 162 and correlative statutes by establishing it had a profit motive through reporting taxable income on its unrelated business tax return. Petitioner primarily argued that Section 512(a)(3), which defines unrelated business income and deductions for exempt social clubs, does not, as a matter of law, require such a profit motive as a prerequisite to deductions. Alternatively, Petitioner argued that, on the facts presented, it had the appropriate profit motive as defined by settled case law.

The Tax Court did not pass on Petitioner's legal argument, but instead reviewed all the facts and circumstances and held that Petitioner had a profit motive for its sales to nonmembers. It relied on the fact

that Petitioner earned a profit when it computed its nonmember food/beverage income using other permissible accounting methods, although it had continuous losses under the permissible accounting method used on the tax return. (App. C, 35a-37a.) In so holding, the Tax Court relied on its prior unanimous reviewed opinion in *North Ridge Country Club* v. *Commissioner*, 89 T.C. 563 (1987).

The Court of Appeals reversed, in a rationale fully explicated in *North Ridge Country Club* v. *Commissioner*, 877 F.2d 750 (9th Cir. 1989)[4], which had similar facts and was argued and decided with the instant case. Noting that "The issue has produced a conflict of decisions between circuits," the court adopted the rationale of the Second Circuit in *The Brook, Inc.* v. *Commissioner*, 799 F. 2d 833 (2d Cir. 1986). The court rejected the reasoning of the Sixth Circuit in *Cleveland Athletic Club* v. *United States*, 779 F. 2d 1160 (6th Cir. 1985). The Ninth Circuit held that Section 512(a)(3) implicitly contains a "trade or business" and profit motive requirement for a deduction, and disregarded the Sixth Circuit's position that Congress deliberately included these requirements in Section 512(a)(1) which governs deductions of other exempt organizations, but excluded those terms from Section 512(a)(3) which authorizes deductions for exempt social clubs. (*Id.* at 1165.) In the instant case, the Ninth Circuit opinion incorporated by reference its interpretation of Section 512(a)(3) in the *North Ridge* opinion. (App. A, 2a.)

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[4] The taxpayer in *North Ridge* filed a petition for rehearing ~~which is still pending before the Ninth Circuit.~~ the petition was denied on September 27 1989.

The Ninth Circuit in *North Ridge* further held that the club there did not have the requisite profit motive, because the club allegedly conceded that it did not intend to make a profit after taking into account variable and fixed costs. The court rejected the club's contention that income in excess of direct costs alone was profit for trade or business purposes.

In the instant case, however, the court of appeals remanded the case to the Tax Court to determine whether Petitioner had a profit motive, "Because * * * Petitioner could have reported gains in excess of direct and indirect costs, but did not do so, relying on a method of allocation stipulated to be reasonable by the Commissioner * * * ." (App. A, 2a-3a.)

REASONS FOR GRANTING THE PETITION

1. The decision below, holding that Section 512(a)(3) of the Code requires an exempt social club to have an intent to earn a profit, consisting of nonmember food and beverage receipts in excess of nonmember variable and fixed expenses, conflicts with the decision of the Sixth Circuit in *Cleveland Athletic Club* v. *United States*, 779 F. 2d 1160 (6th Cir. 1985). In that case, the court of appeals ruled that a tax exempt social club, which had gross receipts from the sales of food and beverages to nonmembers which exceeded related variable expenses, but which were less than the variable and fixed expenses combined, could offset the resulting tax loss against taxable investment income in computing its unrelated business tax liability. The Court reasoned that the "trade or business" requirement contained in Section 512(a)(1) was deliberately left out of Section 512(a)(3), and that a nonprofit club could deduct all nonmember expenses

as long as the club derived a financial benefit from incurring them, even though the nonmember food/beverage activity generated a tax loss.

The opinion below is also in conflict with the decisions of the courts in *University Club of Cincinnati* v. *United States*, S.D. Ohio No. C-1-88-0443, decided April 21, 1989; *Inter-Com Club* v. *United States*, D. Neb. No. CV88-L-39, decided June 26, 1989; and *Detroit Athletic Club* v. *United States*, E.D. Mich. No. 88-CV-71237-DT, decided July 11, 1989.

On the other hand, the Second Circuit has taken a position similar to the court below. In *The Brook, Inc.* v. *Commissioner*, 799 F.2d 833 (2d Cir. 1986), the court held that a tax exempt club could not offset tax losses from sales of food and beverages to nonmembers, where the club's fixed and variable nonmember expenses exceeded its nonmember income, and it conceded it had no profit motive for such business.

2. The question presented is of substantial importance to the administration of the unrelated business tax provisions as applied to tax exempt social clubs. The National Club Association filed *amicus curiae* briefs in the lower courts, and represents about 750 tax exempt clubs nationwide. It stated that approximately 130 clubs have advised it that Internal Revenue Service agents have proposed unrelated business tax assessments of well over $1 million as a result of disallowing tax losses from nonmember food, beverage, and other unrelated business activities which were taken as deductions. This is undoubtedly only a small fraction of the cases which involve the issue, since the Internal Revenue Service has frequently

stated that there are over 50,000 tax exempt social clubs in the United States.

Other cases involving this issue are pending in the lower courts. We are aware of *Petroleum Club of Houston* v. *United States*, Claims Court No. 153-86T, and *Essex County Country Club* v. *United States*, Claims Court No. 204-86T.

This Court's resolution of the issue is needed in order to equalize treatment of tax exempt social clubs throughout the country. Currently, in the Sixth Circuit clubs are routinely receiving very substantial settlements of their unrelated business tax liabilities, as a result of the decision in *Cleveland Athletic Club* v. *United States, supra*. On the other hand, in most other areas of the country, the Internal Revenue Service is not offering any settlements, and is either holding cases in abeyance or requiring the clubs to litigate their cases in full.

The position taken by the Government in interpreting Section 512(a)(3) is contrary to the Treasury's explanation of the statute when it was presented to Congress for its consideration and vote, and is contrary to the enforcement practice of the Government for the first eleven years following the passage of the statute. Indeed, during the litigation below, the Service withdrew the longstanding Proposed Regulations under Section 512(a)(3), which supported Petitioner's position, leaving taxpayers throughout the country without authoritative guidance on the issue. A decision of this Court is necessary to insure the consistent enforcement of the laws in accordance with the intent of Congress.[5]

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[5] The fact that the Ninth Circuit in this case remanded the

3. The Court of Appeals below erred in the interpretation and application of Section 512(a)(3) of the Internal Revenue Code, App. D, *infra*, which sets forth the formula for determining the unrelated business income and deductions of tax exempt social clubs.

Section 511(a), App.D, *infra*, imposes a tax on the "unrelated business taxable income" of certain organizations that are otherwise exempt from taxation under Section 501(a). Section 512(a)(1), App. D, *infra*, sets forth a *general* definition of "unrelated business taxable income" which is *not* applicable to Petitioner. It provides that "unrelated business taxable income" means the gross income derived by any organization from any unrelated *trade or business* (as defined in Section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such *trade or business* • • • (Emphasis added).

This *general* definition creates for most tax exempt entities a narrow category of taxable income and deductions: those that relate to a *trade or business regularly carried on*. It does not tax income from occasional trade or business activity nor does it tax investment income. The expenses relating to these nontaxable activities are not deductible because they are incurred in producing income which is not subject to tax. IRC Section 265.

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case for determination of whether Petitioner had the requisite type profit motive does not prevent this Court from reviewing the legal issue whether Section 512(a)(3) requires a profit motive, in view of the conflict among the circuits on the latter issue. *United States* v. *General Motors Corp.*, 323 U.S. 373, 374 (1945); *Hanover Star Milling Co.* v. *Metcalf*, 240 U.S. 403, 408-409 (1916); *Forsyth* v. *City of Hammond*, 166 U.S. 506 (1897).

Section 512(a)(3) is a special provision, applicable primarily to tax exempt social clubs. It includes a much broader range of income within its definition of unrelated business taxable income. It defines "unrelated business taxable income" for a Section 501(c)(7) organization as the *gross income* (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the *gross income* (excluding exempt function income).

Section 512(a)(1) and Section 512(a)(3) are thus quite different. Section 512(a)(1) defines "unrelated business taxable income" as gross income less related deductions of a "trade or business" regularly carried on by it. It incorporates by specific reference the definition of "trade or business" of Section 513. Section 512(a)(1) was narrowly designed to tax only unrelated "trade[s] or business[es]", because the statute was fundamentally designed to prevent exempt organizations from unfairly competing with taxable businesses. For such organizations, income which did not usually contribute to unfair competition, such as investment income and income from occasional businesses, remained exempt.

In the case of Section 512(a)(3) applicable to social clubs, Congress had an additional goal. Unlike other tax exempt organizations, where the income from unrelated activities is used to further favored societal goals, the unrelated recreational income of a social club is used to reduce the costs members would otherwise pay with after-tax dollars. Congress wanted to treat social clubs in the same manner, for tax purposes, as an aggregate of individuals would be treated when they pooled funds for recreational pur-

poses—member income would be taxed at the individual level, while all other income would be subject to the unrelated business tax.

In 1969, Congress therefore added Section 512(a)(3), which defined "unrelated business taxable income" of a social club broadly to include gross income from any source (other than exempt function income), less the deductions allowed by Chapter 1 of the Code which are directly connected to production of the gross income (other than exempt function income). For purposes of Section 512(a)(3), exempt function income is income received from members for dues, goods or services. The only gross income of a social club which is not subject to tax under Section 512(a)(3) is the income which has been subject to tax at the member level.

It is clear from the legislative history of Section 512(a)(3) that Congress intended to create a new definition of "unrelated *business* taxable income" for social clubs which would include gross income not included in a traditional definition of a "trade or business" and would allow deductions not allowed in the traditional definition of "trade or business" deductions. The House Report accompanying Section 512(a)(3) expressly stated that "all income other than * * * [member income] would be *treated* and taxed as *business* income." H. Rep. No. 413, 91st Cong., 1st Sess. (pt. 1) 47 (1969-3 C.B. 200, 231) (emphasis added). At the time of adoption of the statute, the Treasury Department agreed that this interpretation was intended. In the Treasury Department's explanation of the bill to Congress it stated that "all income, other than that from members in exchange for exempt function facilities, would be included in gross

income, *whether or not the activities generating the income were sufficient to meet the requirements of a trade or business regularly carried on.*"[6] The Treasury's analysis also went on to explain that social clubs need not have a "trade or business" to take deductions under Section 512 (a)(3). It stated that "consistent with the elimination of the 'trade or business regularly carried on' tests, deductions would be allowable if directly connected with *an activity generating income* subject to tax, rather than only if directly connected with an unrelated trade or business * * *."[7]

In the instant case, the Government concedes that Petitioner's tax return has properly allocated the correct amounts and types of nonmember expenses as deductions from unrelated business gross income, and that Petitioner satisfies all the requirements for deductions under both Section 512(a)(3) and the various deduction provisions of the Code, with one exception. The Government and the court below would disallow that portion of the deductions which offset investment income, on the ground that they do not satisfy the "allowed by this chapter" phrase in Code Section 512(a)(3). This phrase assertedly throws the profit motive requirement of Section 162 back into Section 512(a)(3). This Section 162 profit motive test determines whether an activity rises to the level of a trade

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[6] Treasury Tax Reform Studies and Proposals, H. Ways and Means Comm. and S. Fin. Comm. Jt. Pub., Part 3, 319, 324 (Feb. 5., 1969) (emphasis added); *accord*, Technical Explanation of Treasury Tax Reform Proposals, Hearings on Tax Reform before the Comm. on Ways and Means, 91st Cong. 1st Sess., part 14, 5050, 5139-41 (Apr. 22, 1969).

[7] Treasury Tax Reform Studies and Proposals, *supra*, 325.

or business and therefore qualifies for the deduction under Section 162.

This argument fails to give effect to the structure and phraseology of Section 512(a)(3), and its clear legislative history, which eliminated the "trade or business" requirement for both unrelated income and deductions of social clubs. Such a reading improperly prefers the provisions of a general statute over the specific statutory language and legislative history applicable to a specialized taxpayer and institution. See *HCSC* v. *United States*, 450 U.S. 1 (1981). The supersession of Section 162 is particularly erroneous here, since it directly conflicts with Congress' basic purpose in enacting the special definitions of unrelated business income for social clubs in Section 512(a)(3)—to tax income and allow deductions for *all* nonmember activities, including those which do *not* constitute trades or businesses under the general definition of Section 512(a)(1).

As the Tax Court has stated, such an interpretation would "impute a capricious intention to Congress", for it would "tax a social club's nonmember source income, regardless of whether a trade or business was being carried on, but then * * * allow directly related expenses as deductions against such income only if a trade or business was being carried on in such activity." *The Brook, Inc.* v. *Commissioner, supra*, 51 T.C.M. 133, 135 (1985).

4. Even assuming *arguendo* that Section 512(a)(3) incorporates by reference a profit motive test, the Court of Appeals erred in requiring Petitioner to intend to earn a profit, where profit means the production of gains in excess of all variable and fixed overhead costs which are deductible—*viz.*, tax profits. (App. 2a.) The

Tax Court correctly held that Petitioner earned an economic profit and thus had a profit motive, regardless whether Petitioner reported or could have reported taxable income on its return.

The purpose of a profit motive test is to ensure that an activity has as its central purpose economic gain, so that the activity is a "trade or business" rather than an activity designed to satisfy an individual's personal, pleasure, or living purposes. *Cleveland Athletic Club* v. *United States, supra* at *1165; Trustees of Graceland Cemetery Improvement Fund* v. *United States*, 515 F.2d 763 (Ct. Cl.1975); *Anaheim Union Water Co.* v. *Commissioner*, 321 F.2d 253 (9th Cir. 1963).

In the unrelated business tax provisions, the only exemplification of "profit motive" states that the "organization must carry on the activity with the objective that the * * * [activity] will result in *economic profit (without regard to tax consequences.)*" Treasury Income Tax Regulations, Section 1.512(a)-1(f)(7)(ii)(*b*).

The courts have frequently held that "profit" is not the same as taxable income, but means economic profit, independent of tax savings.[8] "Economic profit" is usually different from taxable income,[9] and often

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[8] *Antonides* v. *Commissioner*, 91 T.C. 686, 694 (1988); *Herrick* v. *Commissioner*, 85 T.C. 237, 255 (1985); *Waddell* v. *Commissioner*, 86 T.C. 848, 887 (1986), *aff'd* 841 F.2d 264 (9th Cir. 1988); *Ramsay* v. *Commissioner*, 83 T.C. 793, 810 (1984); *Surloff* v. *Commissioner*, 81 T.C. 210, 233 (1983); *Beck* v. *Commissioner*, 85 T.C. 557, 570 (1985).

[9] See e.g. Treas. Regs. Sections 1.704-1(b)(3)(ii)(*b*) and 1.512(a)-1(f)(7)(ii); *Tolwinsky* v. *Commissioner*, 86 T.C. 1009, 1062 (1986).

means net profits before deductions for fixed costs—*viz.*, cash flow.[10]

An example of the difference between "profit" and "taxable income" was publicized in 1986, when a study showed that numerous major corporations had reported three or four consecutive years of substantial losses for tax purposes, but reported millions of dollars financial profits to their shareholders.[11] Congress acknowledged the difference between profit and taxable income in 1986 by adopting a new minimum tax on "business untaxed reported profits."[12] This provision would not be necessary if profits were identical to taxable income or if the I.R.S. could deny deductions to a corporation merely because the corporation reported several consecutive years of losses for tax purposes.

In the instant case, the Government is trying to collect a few thousand dollars of tax allegedly owed by a small nonprofit corporation, because the club has reported tax losses. But I.R.S. has never contended that it has the right to collect millions of dollars of revenue from large for-profit corporations on the same basis. Moreover, for-profit corporations frequently have losses on some activities—for example, a department store restaurant—which they offset against profits on other activities—for example, the store's retail sales of merchandise. Yet no case or other authority has ever suggested disallowance of such losses because of absence of profit motive. Petitioner merely asks that its taxable activities be taxed using the same economic profit standards applied to for-profit corporations.

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[10] See, e.g., S. Rep. No. 91-552, 91st Cong., 1st Sess. 212 (1969) (1969-3 C.B. 557); H. Rep. No. 91-413, Pt. 1, 91st Cong. 1st Sess. 165 (1969) (1969-3 C.B. 303); H. Rep. No. 94-658, 94th Cong., 2d Sess. 31 (1976-3 C.B. [Vol. 2] 723); *Waddell* v. *Commissioner*, 86 T.C. 848, 884 (Table 10), 887, 894 (1986); *Gefen* v. *Commissioner*, 87 T.C. 1471, 1490-1492 (1986).

[11] A list of such corporations is contained in Citizens for Tax Justice, *130 Reasons Why We Need Tax Reform* (July 1986).

[12] I.R.C. Section 57(f) (1986)

Here, Petitioner had substantial profit on nonmember food and beverage service, computed under three different accounting methods, including at least one favored by the Treasury. (See App. C, 14a-16a, 19a, 20a.) The fact that the admittedly permissible method which Petitioner used in preparing its tax return yielded continuing losses should not negate Petitioner's intent to make a profit.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

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Cathy A. Catterson, Clerk
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NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PORTLAND GOLF CLUB,
Petitioner-Appellee,
v.
COMMISSIONER INTERNAL REVENUE SERVICE,
Respondent-Appellee.

No. 88-7218
Tax Ct. No. 13436-85
MEMORANDUM*

Appeal from a Decision of the
Tax Court of the United States

Argued and Submitted March 6, 1989
Portland, Oregon

Before: CANBY, THOMPSON, and LEAVY,
Circuit Judges.

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* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by Ninth Circuit Rule 36-3.

In North Ridge Country Club v. C.I.R., we recently held that a social club's losses from a non-member activity are not deductible under I.R.C. § 512(a) unless that activity was entered into with the intent of producing gains in excess of direct costs (costs related to the non-member activity) and indirect costs (overhead and other fixed expenses). In so doing, we reversed the tax court's decision, since we concluded the court applied the wrong legal standards for profit under Section 512(a).

The tax court decided this case by applying the same standards we rejected in North Ridge. Because Portland Golf Club could have reported gains in excess

of direct and indirect costs, but did not do so, relying on a method of allocation stipulated to be reasonable by the Commissioner, we REMAND this case to the tax court for a determination of whether Portland Golf Club engaged in its non-member activities with the intent required under North Ridge to deduct its losses from those activities.

REMANDED.

APPENDIX B

UNITED STATES COURT OF APPEALS

For the Ninth Circuit

PORTLAND GOLF CLUB, Petitioner-Appellee,	CA No. 88-7218
v.	Tax Ct No. 13436-85
COMMISSIONER INTERNAL REVENUE SERVICE Respondent-Appellant	**JUDGMENT** MANDATE ISSUED Jun 23, 1989

Upon Petition to Review a Decision of the Tax Court of the United States, _____

_____

This Cause came on to be heard on the Transcript of the Record from the Tax Court of the United States,_____

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___and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the _____ Decision of the said Tax Court of the United States in this Cause be, and hereby is REMENDED

Filed and entered June 1, 1989

APPENDIX C

T.C. Memo. 1988-76

UNITED STATES TAX COURT

PORTLAND GOLF CLUB,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 13436-85.

Filed February 24, 1988.

Allen B. Bush, for the petitioner.[1]

Gerald W. Douglas, for the respondent.

[1] An amicus curiae statement was filed by Leonard J. Henzke, Jr., as counsel for The National Club Association.

MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, Judge: Respondent determined deficiencies in petitioner's income taxes for its fiscal years ending September 30, 1980, and September 30, 1981, in the amounts of $1,828 and $3,470, respectively. The issue for decision is whether petitioner, a social club exempt from tax under Section 501(c)(7)[2], may offset against unrelated business taxable income from interest, an amount which represents the excess of its deductions

[2] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect during the years here in issue. Rule references are to the Tax Court Rules of Practice and Procedure.

over receipts from sales of food and beverages to nonmembers.

FINDINGS OF FACT

Some of the facts have been stipulated and are found accordingly:

Petitioner, the Portland Golf Club, is and at all times relevant to the issues involved in this case, has been a nonprofit Oregon corporation exempt from Federal income tax under the provisions of Section 501(c)(7). At the time of filing its petition herein, petitioner's principal office was located in Portland, Oregon. For each of its fiscal years ending September 30, 1980, and September 30, 1981, petitioner filed a Form 990-T, Exempt Organization Business Income Tax

Return, and a Form 990, Return of Organization Exempt From Income Tax.[3]

Since 1914, petitioner has owned and operated a private golf and country club with a golf course, restaurant and bar, swimming pool, and tennis courts for the benefit of its members, their guests, and nonmembers on a restricted basis. Petitioner's purpose is, and during the years here in issue was, to operate a golf club, restaurant, bar and party facility, swimming pool, and tennis

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[3] The return for petitioner's fiscal year ending September 30, 1980 was a return for a short taxable year of eleven months. Prior to this fiscal year petitioner had a fiscal year ending October 31, but applied for and received authority to change to a fiscal year ending September 30, 1980, resulting in the return for its fiscal year 1980 being for the period November 1, 1979 through September 30, 1980.

courts for the benefit of its members and their guests. Petitioner's exempt activities are the provision of entertainment, dining, and athletic recreation to its members.

During the years in issue petitioner also conducted certain nonexempt activities. During these years petitioner's nonexempt function income was derived from investments which resulted in interest income and from the sales of food and beverages to nonmembers.

Petitioner's members are allowed to sponsor guests, friends, and organizations who wish to use petitioner's facilities and services for private parties, receptions, or catering. Petitioner's nonmember food and beverage

income resulted when these activities did not meet the requirements of Section 512 of the Income Tax Regs. and respondent's ruling thereunder. Petitioner's nonmember food and beverage income from these activities constitutes unrelated business taxable income.

Petitioner incurred variable expenses such as food and beverage costs, payroll, and other expenses in connection with its nonmember sales of food and beverages, as well as overhead and other fixed expenses. Petitioner's overhead and other fixed expenses for the sale of food and beverages to nonmembers consisted of items such as administration, taxes, insurance, and depreciation (hereinafter "fixed expenses"). These fixed expenses would be incurred by petitioner whether

petitioner served nonmembers or not. On its returns' Forms 990-T, petitioner has consistently deducted an allocable portion of overhead and fixed expenses from nonmember income in accordance with Prop. Income Tax Regs. Section 1.512(a)-(3)(b)(5).[4] Since 1975, through and including the years here in issue, petitioner has used an allocation formula based on the ratio that nonmember sales bore to total sales to compute the amount of overhead and fixed expenses allocated to and deducted from petitioner's unrelated business taxable income on its returns. Such method of allocation is

[4] This proposed regulation was withdrawn as of January 23, 1987 by notice published on January 26, 1987 in the Federal Register. 52 Fed. Reg. 2724-2725.

reasonable.[5] For the years at issue an allocable portion of petitioner's overhead costs was properly attributable and directly connected to the generation of nonmember income. Using this method of reporting, petitioner has, since 1975 and up to its fiscal year 1984, incurred losses for tax purposes from the sale of food and beverages to nonmembers and has reported these losses on its Form 990-T returns. Many of petitioner's expenses are fixed expenses relating to maintenance and minimum staff requirements of operating its facilities.

Petitioner's prices for the sales of food and beverages to nonmembers were in

[5] The parties stipulated to this fact in the exact language used in this opinion.

excess of the prices of food and beverages served to members. Petitioner, in determining the prices to be charged for food and beverages to be served to nonmembers attempted to arrive at amounts which would result in the amount received from these sales being in excess of all variable costs directly related to such sales. The variable costs considered were items such as the food costs, supplies, beverage costs and labor costs. Petitioner priced sales of food and beverages to nonmembers so that the cost of food was about 30 percent to 33 percent of the selling price of the meal. Had petitioner chosen to allocate fixed overhead for the years here in issue based on actual use of facilities, it would have had net taxable income for

income tax purposes from the sale of food and beverages to nonmembers as shown by the following schedule:

	11 Months Ending 9/30/80			Year Ending 9/30/81		
	Dining Room	Bar	Total	Dining Room	Bar	Total
Sales	$68,122	$16,300	$84,422	$85,134	$21,413	$106,547
Variable expenses:						
Food & Liquor	27,249	5,183	32,432	34,054	6,617	40,671
Labor & Other Related Costs	14,540	5,281	19,821	16,868	7,259	24,127
Other	8,362	1,206	9,568	11,853	1,756	13,609
	$50,151	$11,670	$61,821	$62,775	$15,632	$78,407
Excess of Sales over Variable Expenses	$17,971	$ 4,630	$22,601	$22,359	$ 5,781	$28,140
Fixed Expenses	3,153	0 *	3,153	4,666	0 *	4,666
Profit	$14,818	$ 4,630	$19,448	$17,693	$ 5,781	$23,474

* Fixed expenses are included under Dining Room.

From its fiscal year 1975 through its fiscal year 1984, the preparation of petitioner's From 990-T, Exempt Organization Business Income Tax Returns, in accordance with the Prop. Income Tax Regs., Section 1.512(a)-3(b)(5), resulted in losses for tax purposes from the sale of food and beverages to nonmembers.

Petitioner's activities were run in a business-like manner and it kept complete and accurate books and records of its activities. Petitioner's operations were overseen by a board of directors (board) of nine members which met at least monthly. The board supervises and reviews the actions of the full-time, professional, general manager, who controls the operations and implements board policy on a day-to-day

basis. During the years at issue, petitioner's board was made up of business people and professionals from various backgrounds. Petitioner's board, finance committee, and staff, in a number of instances, discussed and dealt with the problems relating to petitioner's food and beverage sales, and in these discussions, considered these food and beverage operations as important to petitioner's overall financial operations. From time to time the board discussed the nonmember food and beverage sales of petitioner. Petitioner had a standing finance committee which met monthly to review financial statements, conduct studies concerning the financial aspect of petitioner's operations, and generally to discuss the implementing of

board policy in the area of financial matters. Under date of August 12, 1981, the finance committee addressed a memorandum to the board attaching an analysis of the dining room operations of petitioner. In the analysis, the committee pointed out that whereas ordinary meals served to members at the club resulted in a loss, amounts received from private party functions including nonmember functions, generated higher than average sales and resulted in a profit. One of the conclusions in this report was that since nonmembers spend more than members per meal, the club should increase the number of nonmember meals served each month, and should encourage club members to bring in individuals and other nonmembers for

lunches, dinners and special functions. Subsequently, various other studies were made of the food operations which considered ways of encouraging private parties of members and nonmember activities.

During the years here in issue the manager of petitioner was an individual with a bachelor of science degree in hotel and restaurant administration and a bachelor of science degree in recreation administration. This manager had previous employment with hotels and private clubs. The manager was a certified club manager and had served as an officer of the local chapter of Club Managers' Association of America, as well as a state director of Restaurants of Oregon Association. The price of food

and beverages at nonmember activities was set by the board and the club management at an amount intended to result in a profit to the club over the direct cost associated with the activity. In addition, these activities were intended to attract additional members to the club, resulting in additional income from initiation fees, and to sharpen the skills of the chef and his staff.

During its fiscal year ended September 30, 1980, petitioner received investment income in the form of interest in the amount of $11,752. This interest constituted unrelated business taxable income to petitioner. During its fiscal year ended September 30, 1981, petitioner received investment income in the form of interest in the amount of $21,414, which

also constituted unrelated business taxable income to petitioner. On its Forms 990-T filed for its fiscal years ended September 30, 1980 and September 30, 1981, petitioner showed a loss on food and beverage sales of $28,433 and $69,608, respectively, computed on the basis of deducting an allocable portion of overhead and fixed expenses from nonmember income based on the percentage of nonmember sales to total sales in accordance with proposed Income Tax Regulations, Section 1.512(a)-3(b)(5). Respondent in his notice of deficiency to petitioner included in petitioner's income the interest income received in its fiscal years 1980 and 1981 and disallowed the deductions claimed in those years for losses on food and

beverage sales to nonmembers, as well as the loss carryovers which petitioner claimed based on losses on nonmember food and beverage sales for prior years. Respondent explained the disallowance of the food and beverage losses by stating that--

> food and beverages are being sold to nonmembers at prices insufficient to cover the cost of such sales. These sales have consistently over a number of years only resulted in losses, consequently it is determined that such sales are not profit-motivated and any net loss cannot be deducted in computing unrelated business taxable income.

A similar explanation with respect to nonmember sales in prior years was given for the disallowance of the loss carryovers.

OPINION

Respondent's position in this case is that petitioner's losses, properly computed under his proposed Regulations, from the sale of food and beverages to nonmembers are not deductible by petitioner in determining its unrelated business taxable income since the expenses causing these losses were not incurred in a trade or business carried on for profit and, therefore, are not deductible as business expenses under Section 162. Respondent takes the position that the fact that petitioner shows a profit from the sale of food and beverages to nonmembers when the income from that activity is computed by determining deductible variable expenses on a percentage of use of facilities

basis, is immaterial to determining whether it had a profit motive in conducting that activity, since petitioner actually reported the losses from this activity by allocating the fixed expenses in another acceptable manner.

It is further respondent's position that the primary motivation of petitioner's nonmember business activities was to provide a financial benefit to its members in that the revenues from the sales of food and beverages to nonmembers reduce the need for increasing members' assessments or increasing members' prices. Respondent concludes that since petitioner had no objective expectation of recovering all directly allocable expenses of its

nonmember sales, it did not engage in the selling of food and beverages to nonmembers with a profit motive. Respondent contends that absent a profit motive, petitioner's nonmember sales of food and beverages do not constitute a trade or business and therefore the expenses connected with this activity are not deductible by petitioner under Section 162. Respondent argues that for this reason it is improper to use the losses reported by petitioner from its food and beverage sales to nonmembers to reduce its unrelated business taxable income from interest in each of the years here in issue.

Petitioner, in answer to respondent's contentions, argues that since Section 512(a)(3)(A) defines certain income of

nonprofit social clubs as "unrelated business taxable income" expenses directly connected with the production of that business related income are by definition expenses incurred in a trade or business which meets the requirements of Section 162. Petitioner argues that for this reason the profit motivation test is not applicable in determining whether an activity conducted by a nonprofit social club is a trade or business. Petitioner further argues that in any event it did intend to make a profit and did make a profit on its nonmember food and beverage sales. Petitioner concludes that it therefore properly aggregated income and expenses from all nonexempt sources to arrive at its unrelated business taxable income.

Petitioner, a tax exempt social club, under the provisions of Section 501(c)(7) is generally exempt from income tax under Section 501(a). However, as a nonexempt social club, petitioner is subject to the tax imposed by Section 511 on unrelated business taxable income pursuant to Section 501(b). The term unrelated business taxable income is defined in Section 512(a)(1).[6] Section 512(a)(3)

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[6] Sec. 512(a)(1) provides as follows:

(1) General Rule.--Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in Section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

sets forth specific provisions with respect to the unrelated business taxable income of social clubs.[7] Section 512(a)(3)(B)[8] defines exempt function

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[7] Sec. 512(a)(3)(A) provides as follows:

(A) General Rule.--In the case of an organization described in Section 501(c)(7) or (9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of the gross income (excluding exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b). * * *

[8] Sec. 512(a)(3)(B) provides as follows:

(B) Exempt Function Income.--For purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members or the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the

income as the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid.

It is clear therefore, and neither party argues to the contrary, that amounts paid to petitioner by its members whether by assessment, dues, fees, or for

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exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1), which is set aside * * * .

meals, are exempt income but that all other income received by petitioner is unrelated business taxable income. Its income from sales to nonmembers is by definition unrelated business taxable income. Petitioner argues that because of this definition and the legislative history of Section 512, it follows that it is not necessary that an activity by a social club be a trade or business in the ordinary sense of that term as used in Section 162 to constitute an unrelated taxable income activity of such club. Petitioner argues that respondent in taking a position to the contrary ignores the definition of business taxable income and business activity contained in Section 512. Respondent argues that petitioner is incorrect in its

interpretation of the statute, since the statute specifically provides that the unrelated business taxable income means the gross income less deductions "allowed by this chapter" which are directly connected with the production of gross income. It is respondent's position that deductions "allowed by this chapter" means deductions under Section 162 and that in order for items to be deductible under Section 162 they must be incurred in connection with a trade or business. Respondent in support of his position cites the case of Brook, Inc. v. Commissioner, 799 F.2d 833 (2d Cir. 1986), which affirmed in result a Memorandum Opinion of this Court. Respondent in his brief recognizes that the decision of the Second Circuit in

Brook, Inc. v. Commissioner, supra, might be considered contrary to the decision in Cleveland Athletic Club, Inc. v. United States, 779 F.2d 1160 (6th Cir. 1985). Recently, in a Court-reviewed opinion, we discussed the holding of the Court in Brook, Inc. v. Commissioner, supra, as well as the holding in Cleveland Athletic Club, Inc. v. United States, supra. See North Ridge Country Club v. Commissioner, 89 T.C. 563 (1987). In the North Ridge Country Club case we concluded that it was unnecessary for us to choose between the positions with respect to Section 512(a)(3) taken in Brook, Inc. v. Commissioner, supra and Cleveland Athletic Club, Inc. v. United States, supra, since we had found in the case there under consideration that the

taxpayer's sales of food and beverages to nonmembers were made with a profit motive.

The situation here with respect to food and beverage sales is indistinguishable from the situation involved in North Ridge Country Club v. Commissioner, supra.[9] Petitioner had a

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[9] In fact, after the filing of the opinion in North Ridge Country Club v. Commissioner, 89 T.C. 563 (1987), petitioner forwarded a copy of the opinion to the Court with a letter that stated in part as follows:

> Enclosed please find a copy of the recent Tax Court decision in North Ridge Country Club v. CIR. As you recall, this case involved similar issues as the above-referenced case.
>
> * * *
>
> At present, I do not think additional argument need be made in the Portland Golf Club case other than to say that we concur with the decision in North Ridge Country Club and its rationale.
>
> If, upon reflection, I think further argument would clarify any issue of our case in light of the North Ridge Country Club case, I would petition the court for leave to file a supplemental brief.

A copy of petitioner's letter to the Court with its attachment was sent to respondent's counsel but respondent's counsel did not request that he be permitted to file any further brief in an attempt to distinguish the North Ridge Country Club case from the instant case.

profit from its sales of food and beverages to nonmembers if only the direct costs incurred in connection with those sales are deducted from the receipts from such sales and also had a profit if a further deduction is made for fixed expenses on a use of space allocation. The fixed costs which petitioner deducted to arrive at the loss

for tax purposes were costs which the club would have to pay whether or not it had sales to nonmembers, allocated on a basis of total nonmember sales as compared to total member sales.[10]

We held on the facts in North Ridge Country Club v. Commissioner, supra, that the taxpayer did have a profit motive in its nonmember food and beverage sales activity. Clearly in this case,

[10] Since food and beverages sold to nonmembers were sold at prices in excess of food and beverages sold to members this result is not surprising but rather might well be anticipated. Respondent has stipulated in this case, however, that this method of allocation is proper and acceptable in computing petitioner's unrelated business taxable income from food and beverage sales. We therefore have not considered whether the facts in this case support such an expense allocation in arriving at income or loss from nonmember food and beverage sales for income tax purposes.

petitioner likewise had a profit motive in its nonmember food and beverage sales activity. It did intend to make a profit, and did make a profit between the amount received from sales to nonmembers and the costs related to those sales which would not have been incurred absent those sales.[11] It is only by allocating a part of the expenses which petitioner

[11] We have not ignored respondent's statement that this is not a fact for petitioner's fiscal year 1981. However respondent bases this statement on a schedule in petitioner's Form 990-T for its fiscal year 1981 which did not properly segregate costs which would not have been incurred absent the nonmember sales from other costs. The evidence clearly shows that petitioner had income from nonmember sales based on deducting from such sales only expenses which would not have been incurred absent such sales and respondent does not seriously contend to the contrary.

would have in all events incurred on a sales ratio basis, permitted by respondent, to the sales to nonmembers, that a loss results.

In North Ridge Country Club v. Commissioner, supra, we stated with respect to respondent's argument that profit motive on any allocation of fixed expenses other than the allocation method used on the taxpayer's returns was immaterial in determining the taxpayer's profit motive as follows (89 T.C. at 572-573):

> Respondent contends, however, that we must look to taxable income in order to determine whether there is profit motivation. He argues that since petitioner is allowed to deduct an allocable portion of the fixed or indirect costs in arriving at unrelated business taxable income, petitioner should also be required to take these costs into consideration in regard to determining profit motivation. Petitioner is, in

> effect, says respondent, having it both ways. While there is a certain pleasing symmetry to respondent's argument, we do not believe it to be determinative of the question before us.18/ The record as a whole makes it apparent that petitioner was seeking profit from these activities and we so hold.

18/ We note that it is respondent who allows the deduction of the indirect fixed costs against the nonexempt income; costs which otherwise would be borne in their entirety by the club membership.

Respondent argues that to permit petitioner to offset the loss from its nonmember sales of food and beverages computed in accordance with respondent's proposed regulations against other unrelated business taxable income, in effect, permits petitioner to use these nonmember activities to cause its dues, assessments, and meal costs to its members to be less. It is respondent's

members to be less. It is respondent's position that it was to avoid such a result that Congress enacted the special provision with respect to unrelated business taxable income for social clubs exempt from tax under Section 501(c)(7). This same argument was made by respondent in North Ridge Country Club v. Commissioner, supra, and was rejected.

*** Likewise respondent's reliance on Ye Mystic Krewe of Gasparilla v. Commissioner, 80 T.C. 755 (1983), is misplaced. The facts in that case differ substantially from the facts in the instant case. In that case as we explained in North Ridge Country Club v. Commissioner, supra, we held that the taxpayer could not offset its expenses of staging a mock invasion of Tampa and a

and beverages to nonmembers results in a loss when the costs related thereto including a pro rata part of fixed expenses (computed by a method respondent agrees is acceptable) are considered.

In our view there is no distinction between the instant case and the situation we considered in North Ridge Country Club v. Commissioner, supra, a Court-reviewed case. Based on our reasoning and holding in that case, and for the reasons set forth herein, we hold that petitioner is entitled to offset its unrelated business taxable income from interest by its loss from its nonmember food and beverage sales computed by allocating a portion of its fixed expenses to the nonmember food and

beverage sales activity in a manner which respondent agrees is acceptable.[12]

Decision will be entered for the petitioner.

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12 Respondent does not argue in this case as he did in North Ridge Country Club v. Commissioner, 89 T.C. 563 (1987), that petitioner is not entitled to offset a loss from one of its unrelated business taxable income activities against a profit from another such activity. Here respondent only argues that the loss from petitioner's nonmember food and beverage sales should not be offset against the interest unrelated business taxable income because the nonmember food and beverage sales activity was not engaged in with a profit motive. Since we have concluded that the activity was further, based on respondent's argument, whether the excess of expenses over income from the nonmember sales of food and beverages may be deducted from the interest income received by petitioner.

APPENDIX D

INTERNAL REVENUE CODE OF 1954
(26 U.S.C.) § 511 (a)

Sec. 511. IMPOSITION OF TAX ON UNRELATED BUSINESS INCOME OF CHARITABLE, ETC., ORGANIZATIONS.

(a) Charitable, Etc., Organizations Taxable at Corporation Rates. --

(1) Imposition of tax. -- There is hereby imposed for each taxable year on the unrelated business taxable income (as defined in section 512) of every organization described in paragraph (2) a tax computed as provided in section 11. In making such computation for purposes of this section, the term "taxable income" as used in section 11 shall be read as "unrelated business taxable income."

§ 511 (cont.)

(2) Organizations subject to tax. --
(A) Organizations described in sections 401(a) and 501(c). -- The tax imposed by paragraph (1) shall apply in the case of any organization (other than a trust described in subsection (b) or an organization described in section 501(c)(1) which is exempt, except as provided in this part or part II (relating to private foundations), from taxation under this subtitle by reason of section 501(a).

Internal Revenue Code of 1954 (26 U.S.C.) §512(a)_

§512. Unrelated business taxable income
(a) Definition. -- For purposes of this title --
(1) General rule. -- Except as otherwise provided in this subsection, the term "unrelated business taxable income" means the gross income derived by any organization from any unrelated trade or business (as defined in section 513) regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business, both computed with the modifications provided in subsection (b).

* * *

§ 512 (a) (cont.)

(3) Special rules applicable to organizations described in section 501(c)(7) or (9). --

(A) General rule. -- In the case of an organization described in section 501(c)(7) or (9), the term "unrelated business taxable income" means the gross income (excluding any exempt function income), less the deductions allowed by this chapter which are directly connected with the production of gross income (including exempt function income), both computed with the modifications provided in paragraphs (6), (10), (11), and (12) of subsection (b). For purposes of the preceding sentence, the deductions provided by sections 243, 244, and 2345 (relating to dividends received by corporations) shall be treated as not directly connected with the production of gross income.

§ 512 (a) (cont.)

(B) Exempt function income. -- For purposes of subparagraph (A), the term "exempt function income" means the gross income from dues, fees, charges, or similar amounts paid by members of the organization as consideration for providing such members or their dependents or guests goods, facilities, or services in furtherance of the purposes constituting the basis for the exemption of the organization to which such income is paid. Such term also means all income (other than an amount equal to the gross income derived from any unrelated trade or business regularly carried on by such organization computed as if the organization were subject to paragraph (1)), which is set aside --

§ 512 (a) (con't)

(i) for a purpose specified in section 170(c)(4), or

(ii) in the case of an organization described in section 501(c)(9), to provide the payment of life, sick, accident, or other benefits, including reasonable costs of administration directly connected with a purpose described in clause (i) or (ii).

If during the taxable year, an amount which is attributable to income so set aside is used for a purpose other than that described in clause (i) or (ii), such amount shall be included, under subparagraph (A), in unrelated business taxable income for the taxable year.